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No. 09 091417

IN THE

# Supreme Court of the United States

UNITED RENTALS, INCORPORATED,

*Petitioner,*

*v.*

JAMES BIGELOW ANGELL,

*Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

## PETITION FOR A WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

1. In order to satisfy the elements of 11 U.S.C. § 547(b), must a bankruptcy trustee prove that the allegedly preferential transfers diminished the bankruptcy debtor's estate available for distribution to general unsecured creditors?

2. Is the contemporaneous release of contingent setoff rights or a contingent security interest in property of the estate by a third-party as a direct result of an alleged preferential transfer a valid contemporaneous exchange for new value under 11 U.S.C. § 547(*c*)(1)?

## RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Petitioner, United Rentals, Inc., has no parent corporation and no publicly held company owns 10% or more of its stock.

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## PETITION FOR A WRIT OF CERTIORARI

United Rentals, Inc. ("United Rentals") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

## OPINIONS BELOW

The January 22, 2010 opinion of the Court of Appeals for the Fourth Circuit is reported at 592 F.3d 525 and reproduced in the appendix hereto ("App.") at 1a.

The January 22, 2009 Order of the United States District Court for the Eastern District of North Carolina affirming the judgment of the bankruptcy court is unpublished and reproduced at App. 19a.

The April 30, 2008 Order of the Bankruptcy Court for the Eastern District of North Carolina granting the Trustee's motion to amend the judgment and denying United Rentals motion to stay is unpublished and reproduced at App. 27a. The March 31, 2008 Order of the bankruptcy court granting judgment in the amount of $66,963.74 to the Trustee is unpublished and reproduced at App. 34a. The June 14, 2007 Order of the bankruptcy court granting the Trustee's motion for summary judgment, and denying in part and granting in part United Rentals' motion for summary judgment is unpublished and attached hereto at App. 39a.

The February 19, 2010, order of the Court of Appeals for the Fourth Circuit denying United Rental's petition for rehearing or rehearing en banc is reproduced at App. 51a.

## JURISDICTION

The judgment of the court of appeals was entered on January 22, 2010. App. 1a. On February 19, 2010, that court denied a timely filed petition for rehearing or rehearing en banc. App. 51a. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

## STATUTORY PROVISIONS INVOLVED

Section 547(b) of the Bankruptcy Code, 11 U.S.C. § 547(b), provides:

> (b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

> (5) that enables such creditor to receive more than such creditor would receive if—
>
> > (A) the case were a case under chapter 7 of this title;
> >
> > (B) the transfer had not been made; and
> >
> > (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Section 547(c)(1) of the Bankruptcy Code, 11 U.S.C. § 547(c)(1), provides:

> (c) The trustee may not avoid under this section a transfer—
>
> > (1) to the extent that such transfer was—
> >
> > > (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
> > >
> > > (B) in fact a substantially contemporaneous exchange;

## STATEMENT OF THE CASE

### I. Introduction

"The Bankruptcy Code's preference section serves two goals." App. 3a. "First, it prevents companies from 'racing to the courthouse to dismember the debtor during his slide into bankruptcy.'" App. 3a. "And second, it protects 'equality of distribution among creditors of the debtor.'" App. 3a. This case is about the interplay between those Bankruptcy Code preference provisions and mechanic's lien rights under state statute or payment bond rights under the federal Miller Act, state Little Miller Acts and private payment bonds. It raises the important question how a contractor who was protected by these remedies before receiving payment can be subject to a preference claim to recover payments received, while a contractor who was not paid retains those protections and the ability to receive payment even after the debtor files bankruptcy. The Fourth Circuit's decision in this case conflicts with the decisions of other circuits and creates the inequitable and illogical scenario where a construction contractor is prejudiced by accepting payment for its work.

It is not uncommon for a construction contractor to suffer financial difficulties that threaten to stall work on construction projects because of nonpayment to subcontractors and suppliers. To limit this risk of nonpayment and the resulting consequences of delayed and higher cost construction projects, state legislatures passed mechanic's lien statutes to provide security to construction contractors on private construction projects. Similarly, the federal government recognized

the importance of assuring payment to construction contractors on public construction projects and passed the Miller Act, requiring payment bonds for the protection of construction contractors. The legislatures of every state in the country followed suit with a so-called "Little Miller Act" for the same purpose. All of these statutes recognize the economic importance of protecting construction contractors and facilitating lower priced construction projects through limitations on risks.

Despite clear conflicts with the decisions of other circuits, the Fourth Circuit's decision in this case denies that preferred status to the very creditors those laws seek to protect. The result of this decision is that, in the event of bankruptcy, a construction contractor is only protected from the risk of nonpayment if that contractor does not receive payment. An unpaid contractor is protected by these remedial mechanisms and can collect payment for its work, despite the bankruptcy. In contrast, a contractor who has been paid is prevented from pursuing these remedies and is then forced to return the payments to the debtor at a time beyond the deadlines to preserve any remedy. The paid contractor retroactively becomes unprotected. This is exactly what the state legislatures and the federal government have sought to prevent through legislation.

The consequences of this decision on the construction industry are immeasurable. The only way a construction contractor can protect itself against a later preference claim is to refuse payment from a debtor and instead actually file its payment bond claim or mechanic's lien prior to accepting payment. This works

against the very purpose of the preference provisions and promotes dismemberment of the debtor during his slide into bankruptcy. Rather than preventing the race to the courthouse, the Fourth Circuit has made it mandatory.

This Court should grant certiorari to resolve the conflicts created by the Fourth Circuit's decision and to prevent this unwarranted encroachment on the long-held protections of construction contractors established by contract, and state and federal law.

## II. Factual Background

Prior to filing its bankruptcy petition on September 1, 2004, Partitions Plus of Wilmington, Inc. ("Partitions") was working as a subcontractor for Bovis Lend Lease, Inc. on a construction project known as Dosher Memorial Hospital ("Dosher Project"). Partitions enlisted United Rentals, Inc. ("United Rentals") to supply the rental equipment needed. Throughout the Dosher Project, United Rentals provided various rental equipment to Partitions on an open account and periodically received payments from Partitions. United Rentals last supplied rental equipment to Partitions for use on the Dosher Project on June 1, 2004.

During that same time, Partitions was also working as a subcontractor for EMJ Corporation on a construction project known as Mayfair Town Center ("Mayfair Project"). Partitions was similarly using rental equipment rented from United Rentals on that project. United Rentals' last supply of rental equipment to Partitions for the Mayfair project was on September 22, 2004.

On both the Dosher Project and the Mayfair Project, Partitions entered into payment bonds with United States Fire Insurance Company ("U.S. Fire") for the protection of those supplying labor, materials and rental equipment to Partitions. Under the terms of the payment bonds on these projects, United Rentals could have asserted a claim against U.S. Fire for any monies owed to United Rentals for rental equipment used on the projects. A suit against U.S. Fire on the payment bonds could have been commenced until the "expiration of the minimum period of limitation permitted by any law."

North Carolina law gives a subcontractor "a lien upon funds that are owed to the contractor with whom the . . . subcontractor dealt and that arise out of the improvement on which the . . . subcontractor worked or furnished materials." N.C. GEN STAT. §44A-18 (2010). United Rentals provided undisputed evidence that the contractors with whom Partitions dealt owed Partitions amounts greater than the amount of the alleged preferential transfers both at the time of the transfers and as of the date the petition was filed.

North Carolina law also provides a claim of lien on real property that must be filed within 120 days of the last supply of work to the project. N.C. GEN. STAT. § 44A-12 (2010). Pursuant to this statute, United Rentals had until January 20, 2005 to perfect its lien on real property rights on the Mayfair Project.[1]

1. The North Carolina lien on funds, applicable to both projects, and the North Carolina lien on real property, applicable only to the Mayfair Project are hereinafter collectively referred to as "mechanic's liens."

As of the date of the alleged preferential transfers and the date of Partitions' bankruptcy petition, United Rentals was still within any deadline to make a claim against U.S. Fire or to file mechanic's liens. For the common sense reason that it had received payment of the monies owed on these projects, United Rentals never made a claim against the bonds or filed any mechanic's liens related to either project.

## III. Bankruptcy Court Proceedings[2]

On September 1, 2004, Partitions filed a chapter 11 bankruptcy petition in the Bankruptcy Court for the Eastern District of North Carolina. On November 4, 2004, the case was converted to a chapter 7 proceeding and James B. Angell was appointed Trustee for the liquidation (Mr. Angell is hereinafter referred to as the "Trustee").

On July 14, 2006, the Trustee filed a complaint in the bankruptcy court seeking to recover $75,849.40 from United Rentals pursuant to 11 U.S.C. § 547 and 11 U.S.C. § 550(a). App. 40a 41a. The bankruptcy court had jurisdiction over the Trustee's complaint pursuant to 28 U.S.C. §§ 157 and 1334. This Complaint alleged that $75,849.40 in transfers were made to United Rentals for or on account of an antecedent debt while the debtor was insolvent and that these transfers were made within 90 days of the date of the petition date.[3] App. 42a. Most

2. The discussion of the bankruptcy court proceedings is limited to those issues relevant to the question presented in this writ.

3. United Rentals did not dispute any of these allegations at summary judgment or trial.

importantly for this appeal, the Trustee further alleged that the transfers "enabled the Defendant to receive more from the Debtor than it would have received in a Chapter 7 case had the transfers not been made and the Defendant received payment on its claim to the extent provided by Title 11 of the United State Code." App. 42a.

United Rentals moved for summary judgment on the basis that the Trustee could not show that the alleged preferential payments enabled United Rentals to receive more than it would have if the transfer had not been made. App. 5a. The Trustee filed a cross-motion for summary judgment on this issue asserting that it had met its burden under § 547(b) by showing that general unsecured creditors would not receive one hundred percent of their claims from the assets of the bankruptcy estate. App. 5a.

The court ruled that the Trustee had met his burden of proof and granted the Trustee's motion for summary judgment. App. 48a. It reasoned that, while United Rentals argued it would have received payment in full from the surety had it not been paid, the court's analysis is limited to "whether in a chapter 7 liquidation there would have been enough funds to pay this creditor's claim *out of the estate*." App. 48a (emphasis added).

This matter then proceeded to trial on February 28, 2008 on United Rentals' affirmative defenses. At trial, United Rentals presented the argument that the release of its inchoate mechanic's lien rights and its rights against the payments bonds at the time of the alleged preferential transfers constituted a contemporaneous

exchange for new value under 11 U.S.C. § 547(c)(1). The bankruptcy court, relying on its own unpublished opinion issued eleven days before in *Angell v. Pennington*, Adv. Pro. 06-00148-8-AP (Bankr. E.D.N.C. March 20, 2008), set forth a two part test to determine whether such a defense existed. App. 37a. This test required that a creditor show "(1) it would have timely filed a claim against the project's payment bond and been paid in full had it not received payment from the debtor, and (2) at the time, the debtor was still owed funds by the general contractor on which the bonding company could have asserted a lien." App. 37a.

United Rentals presented undisputed evidence establishing element two of the *Angell v. Pennington* test. This evidence showed that the owners and general contractors on both projects were holding funds in excess of the alleged preferential payments both at the time of the transfers and at the time of bankruptcy petition. App. 37a.

The bankruptcy court, however, focused on the first element of its self-created test in making its decision. App. 37a-38a. It determined that because United Rentals had not established that it "would have filed a bond claim and been paid in full had it not received the preferential payment," the contemporaneous exchange for value defense of § 547(c)(1) was not available to United Rentals. App. 37a-38a.

Relying on *Precision Walls v. Crampton (In re Precision Walls)*, 196 B.R. 299 (E.D.N.C. 1996), the bankruptcy court determined that United Rentals was an unsecured creditor because it had not perfected its

lien rights prior to receiving payment from Partitions. App. 36a. The court deemed this opinion dispositive of United Rentals' 547(c)(1) defense based on the release of its inchoate mechanic's liens and found in favor of the Trustee on this argument.[4] App. 36a.

On these bases the court ruled that United Rentals did not have a valid defense to the claim of the Trustee and that the transfers could be avoided as preferential. App. 38a. On March 31, 2008, the bankruptcy court entered judgment in favor of the Trustee in the amount of $66,963.74. App. 38a.

**IV. The District Court Decision**

United Rentals appealed the bankruptcy court's decisions at summary judgment and trial to the United States District Court for the Eastern District of North Carolina. The district court had jurisdiction over United Rentals' appeal pursuant to 28 U.S.C. §§ 158 and 1334. On January 2, 2009, without holding oral argument, the district court issued an unpublished order affirming the bankruptcy court's decision. App. 19a-26a.

4. Throughout this litigation the Trustee has never been able to point to any case outside of the Eastern District of North Carolina that required a creditor prove that it had actually perfected mechanic's lien or bond rights prior to payment or to prove what it would have done absent payment for the purposes of a § 547(c)(1) defense. This test, which became the law of this case until Fourth Circuit review, is a creation of the bankruptcy court and district court of the Eastern District of North Carolina alone.

The district court held that the Trustee had proved that United Rentals received more than it would have had the transfers not occurred. App. 24a. This determination was based on the Fourth Circuit's opinion in *Smith v. Creative Financial Mgmt, Inc. (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193 (4th Cir. 1992) and the statement therein that "[t]he court must focus, not on whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead upon whether the creditor would have received less than a 100% payout in [a] Chapter 7 liquidation." App. 24a. Because United Rentals would not have received one hundred percent of the allegedly preferential transfers as a general unsecured creditor *directly from the estate* in the hypothetical chapter 7, the court determined the Trustee had met its § 547(b) burden. App. 24a. The court undertook no analysis of the actual impact of the transfers on the estate. App. 24a.

The district court also affirmed the two part test created by the bankruptcy court to determine if United Rentals had § 547(c)(1) defense because of its bond rights. App. 25a.

The district court gave only a cursory review to United Rentals' release of inchoate mechanic's liens. In fact, the only determination made by the court in affirming the bankruptcy court summary judgment order was that "Appellant is an unsecured creditor because it failed to file notice." App. 24a. Like the bankruptcy court, the district court reached this conclusion by reference to its own decision in *Precision Walls v. Crampton (In re Precision Walls)*, 196 B.R. 299 (E.D.N.C. 1996). App. 24a.

On these bases, the district court affirmed the bankruptcy court's grant of summary judgment to the Trustee and denial of United Rentals' contemporaneous exchange for new value defense.

## V. The Court of Appeals Decision

United Rentals then appealed to the Fourth Circuit Court of Appeals arguing that the Trustee failed to meet its burden of proof under 11 U.S.C. § 547(b) and that United Rentals had established a defense pursuant to 11 U.S.C. § 547(c)(1). The Fourth Circuit had jurisdiction over United Rentals' appeal pursuant to 28 U.S.C. § 158.

Looking first at the question of whether the Trustee had met it burden of proof under § 547(b), the Fourth Circuit, like the district court before it, relied on its decision in *Virginia-Carolina Financial Corporation* to reason that the proper analysis is not what the specific creditor would have received had the transfers not been made, but what the creditor would have received as a general unsecured creditor *directly from the bankruptcy estate* had the transfer not been made. App. 9a-10a. On this basis, the court affirmed the holding below. App. 9a-10a, 18a.

Looking next at the § 547(c)(1) defense argued by United Rentals, the court the considered the "indirect transfer theory." App. 10a-17a. The Fourth Circuit did not discuss the bankruptcy court's two-element test. *See generally* App. 1a-18a. Rather it based its decision on the fact that "the Surety never obtained any lien that it could release." App. 13a. Under this reasoning, the

necessary consideration is whether the surety held a lien at the time of the payment, not whether United Rentals could have and would have made a claim against the payment bonds. App. 13a. As the allegedly preferential $66,963.74 was paid to United Rentals by Partitions rather than U.S. Fire, no such lien existed and United Rentals had no contemporaneous exchange for new value defense based upon an indirect transfer. App. 14a.

Unlike the district court, the Fourth Circuit also considered United Rentals' inchoate mechanic's liens in the context of the contemporaneous exchange for new value defense. The court reasoned that "United [Rentals] did not have a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest." App. 15a. In support of this position, the court reviewed the North Carolina mechanic's lien statutes and determined that the "North Carolina's mechanic's lien statutes grant a supplier of labor and material only *the right to file a claim of lien* on real property." App. 16a. (emphasis in original). The court then held that, because United Rentals had nothing more than a right to file a lien and had not exercised that right before payment, it had nothing to release at the time of the transfers and therefore no defense under 11 U.S.C. 547(c)(1). App. 16a-17a.

United Rentals filed a timely petition for rehearing or rehearing en banc, which the court denied on February 19, 2010. App. 51a.

## REASONS FOR GRANTING THE PETITION

### I. The Decision Below Conflicts with the Decisions of Other Circuit Courts

The petition should be granted because the Fourth Circuit's opinion conflicts with the decisions of other circuit courts. *See* S. Ct. Rule 10(a). Because of this conflict, the protection afforded a construction contractor by a payment bond or mechanic's lien statutes when a bankruptcy intervenes will vary depending on the geographical location of the construction project. This Court should not allow this inconsistent application of bankruptcy law and the resulting confusion to exist, and should grant certiorari.

#### A. The decision of the Fourth Circuit conflicts with decisions of the Sixth Circuit requiring a showing that the bankruptcy estate was diminished for a transfer to be preferential under 11 U.S.C. § 547(b).

Under the Bankruptcy Act, it was unquestionable that a transfer had to diminish the estate to be avoided as preferential. *See Nat'l Bank of Newport v. Nat'l Herkimer County Bank*, 225 U.S. 178, 184, 32 S. Ct. 633, 56 L. Ed. 104 (1912) ("the act condemns, . . . the appropriation by the insolvent debtor of a portion of his property to the payment of a creditor's claim, so that thereby the estate is depleted and the creditor obtains an advantage over other creditors"); *Bailey v. Baker Ice Machine Co.*, 239 U.S. 268, 274, 36 S. Ct. 50, 60 L. Ed. 275 (1915) ("It therefore is plain that § 60b [of the Bankruptcy Act] refers to an act on the part of a

bankrupt whereby he surrenders or encumbers his property or some part of it for the benefit of a particular creditor and thereby diminishes the estate").

In twenty-plus years of precedent, the Sixth Circuit has retained this element, holding that to satisfy § 547(b) a trustee must show that the alleged preferential transfers diminish the estate available to unsecured creditors. *See Chase Manhattan Mortgage Corp. v. Shapiro (In re Lee)*, 530 F.3d 458, 464 (6th Cir. 2008) ("Although § 547(b) does not expressly make diminution of the estate an element of a preference claim, diminution is understood to be a requirement as a result of § 547(b)(5)'s improvement-in-position test"); *Stevenson v. Leisure Guide of America, Inc. (In re Shelton Harrison Chevrolet, Inc.)*, 202 F.3d 834, 836-37 (6th Cir. 2000) ("Specifically, the bankruptcy trustee may avoid any transfer of the debtor's property to a creditor . . . that diminishes the estate") (internal quotation marks omitted); *McLemore v. Third National Bank (In re Montgomery)*, 983 F.2d 1389, 1394 (6th Cir. 1993) ("We agree, of course, that a voidable preference necessarily depletes the debtor's estate; without such a depletion, there cannot be a voidable preference"); *Waldschmidt v. Mid-State Homes, Inc. (In re Pitman)*, 843 F.2d 235, 238 (6th Cir. 1980) (stating that § 547(b) "declares that the bankruptcy trustee 'may avoid any transfer' of the debtor's property to a creditor 'for or on account of an antecedent debt owed by the debtor before such transfer was made' that diminishes the estate or creates an inequality among classes of creditors").

In its 2008 opinion in *In re Lee*, the Sixth Circuit could not have been clearer that dimunition of the estate is a necessary element of § 547(b). There the court wrote, "[t]he concept here is the same as the idea developed in old Supreme Court opinions under old bankruptcy acts—that a voidable preference must 'impair,' or 'diminish,' the estate." *In re Lee*, 530 F.3d at 464. Although not as explicit, the Eleventh Circuit has also deemed it necessary under § 547(b) to analyze whether an alleged preferential payment diminished the estate. In *Bank of America N.A. v. Mukamai (In re Egidi)*, 571 F.3d 1156 (11th Cir. 2009), the Eleventh Circuit extensively analyzed the effect of a transfer on the debtor's estate, to determine whether the bankruptcy trustee had satisfied § 547(b). *Id.* at 1161. The court ultimately determined that "[b]ecause the transfer was within the control of . . . the debtor, and the transfer diminished the assets in the estate available to other creditors, the transfer was a preference, which could be avoided by the trustee." *Id.* at 1162.

Similarly, the Eighth Circuit in *Wells Fargo Home Mortgage, Inc. v. Lindquist*, 592 F.3d 838 (8th Cir. 2010), performed an analysis of whether the alleged preferential transfer diminished the estate to determine whether § 547(b)(5) was satisfied. *Id.* at 844-45. Ultimately the court concluded that "the transfer of the mortgage to [creditor] diminished the bankruptcy estate" and affirmed the holding of the bankruptcy court that the trustee had satisfied § 547(b)(5). *Id.* at 845.

The Fifth, Seventh and Tenth Circuits also continually include diminishment principles in § 547(b) elements. *See Caillouet v. First Bank & Trust (In re Entringer Bakeries Inc.)*, 548 F.3d 348 (5th Cir. 2008) (noting that the earmarking doctrine is based on the concept that the transfer "in no way diminishes the debtor's estate."); *Coral Petroleum, Inc. v. Banque Paribas-London*, 797 F.2d 1351, 135 (5th Cir. 1986) ("For the preference to be voided under section 547, it is essential that the debtor have an interest in the property transferred so that the estate is thereby diminished") (internal quotation marks omitted); *Warsco v. Preferred Technical Group*, 258 F.3d 557, 564 (7th Cir. 2001) (noting that "[c]ourts considering [§ 547(b)] have focused on whether the transfer diminished the debtor's estate"); *In re Smith*, 966 F.2d 1527, 1535 (7th Cir. 1992) ("But courts have also long held that to be avoidable, transfers must result in a depletion or diminution of the debtor's estate"); *Parks v. FIA Card Services, N.A. In re Marshall)*, 550 F.3d 1251, 1257-58 (10th Cir. 2008) (considering whether the estate was diminished in determining whether § 547(b) was satisfied).

The Fourth Circuit disagrees. Before the Fourth Circuit and the lower courts, United Rentals argued that the Trustee had failed to meet its burden of proof under 11 U.S.C. § 547(b) because it had not shown that the alleged preferential transfer diminished the estate available to the unsecured creditors of Partitions. This argument was based on this Court's decision in *Pearlman v. Reliance Insurance. Company*, 371 U.S. 132, 83 S. Ct. 232, 9 L. Ed. 2d 190 (1962), where it was held that a surety on a construction project has an equitable lien against funds owed to the bond principal. *Id.* at 141-42. Under the *Pearlman* decision, a payment

by U.S. Fire to United Rentals would have resulted in an equivalent secured claim against the estate by U.S. Fire. *See id.* ("since the surety in this case has paid out more than the amount of the existing fund, it has a right to all of it"). United Rentals established at trial that this secured claim held by U.S. Fire would have been fully secured by assets of the estate. As a result, the alleged preferential transfer would not cause any decrease in the estate available for distribution to unsecured creditors relative to the value of the estate that would have been available had the payments not been made.

In response to this argument, the Fourth Circuit reasoned that a court need not determine the actual effect of allegedly preferential transfers on the diminution of the estate. App. 9a-10a. Rather the Fourth Circuit and the lower courts limited their analysis to what United Rentals would have been paid directly from the estate as a general unsecured creditor in the hypothetical Chapter 7 distribution of § 547(b). App. 9a-10a. This analysis is admittedly consistent with the Ninth Circuit's decision in *Committee of Creditors Holding Unsecured Claims v. Koch Oil Company (In re Powerine Oil Company)*, 59 F.3d 969 (9th Cir. 1995). There, Judge Kozinski determined that such a limited analysis was appropriate despite the illogical outcome upon its application. *Id.* at 971, 973 ("Can an unsecured creditor be better off when the debtor defaults rather than paying off the debt? Yes: Law can be stranger than fiction in the Preference Zone").[5]

5. The panel in *Powerine* could not reach a consensus on this very issue. Judge Farris authored a dissent, stating "[t]he plain language of the statute does not limit consideration to funds from the [debtor's] estate." *In re Powerine Oil Company*, 59 F.3d at 974.

Both the Fourth Circuit in reaching its decision in this matter and the Ninth Circuit in *Powerine* turn to a Fourth Circuit decision that does not support their conclusions and is not in conflict with the Sixth Circuit. In *Smith v. Creative Financial Mgmt, Inc. (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193 (4th Cir. 1992), much like in the current case, the creditor could have made a claim against a third party for payment of its debt had it not received payment from the debtor. *Id.* at 195. Unlike the current case, that third party would not have anything more than an unsecured claim against the debtor's estate or estate assets. *Id.* at 198. Because holding otherwise would result in a diminishment of the estate available for distribution to unsecured creditors, the *Virginia-Carolina Financial Corporation* court determined that the bankruptcy trustee had met its burden of proof under § 547(b)(5). *See id.* at 199 (stating that the preferential transfer was "at the expense of the debtor's other creditors").

In support of this holding, the *Virginia-Carolina Financial Corporation* court wrote, "[t]he court must focus, not on whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead upon whether the creditor would have received less than a 100% payout in [a] Chapter 7 liquidation." *Id.* Both the Fourth and Ninth Circuits have used this language as a basis for analyses that do not consider the actual effect of the transfer on the diminution of the estate but instead require comparison of the transfer to payment as a general unsecured creditor in a direct distribution from the bankruptcy estate. To say that the court must not focus on whether a creditor may have recovered all of the monies "from

any source whatsoever," however, does not mean that there is only *one* source of funds shielded from preference attack, a distribution to general unsecured creditors directly from the bankruptcy estate. The critical question instead is whether this particular creditor could have received the same payment in a chapter seven liquidation and whether the estate was diminished by the prepetition transfer. This misapplication of the *Virginia-Carolina Financial Corporation* court's opinion is in direct conflict with precedent of the Sixth Circuit requiring a trustee to establish that a bankruptcy transfer was at the expense of other creditors to be preferential.

The Ninth Circuit in *Powerine* relies on a pre-Bankruptcy Code decision from the Eight Circuit stating that "the key factor in determining whether a payment is a preference is the 'percentage . . . [creditors'] claims are entitled to draw out of the estate of the bankrupt.'" *In re Powerine Oil Company*, 59 F.3d at 972 (bracketed material in original) (emphasis omitted). The 1902 decision cited, *Swarts v. Fourth National Bank*, 117 F. 1 (8th Cir. 1902), does not answer the question whether a payment that eliminates the secured claim of a third party is a preference. In fact, there the Eight Circuit extensively analyzed the diminishing effect the preferential transfer had on the debtor's estate. *Id.* at 4-7 (noting that the third party would have an unsecured claim against the bankruptcy estate if called upon to pay the creditor). The statements relied on by the Ninth Circuit are merely an acknowledgment that the transfers were preferential because they would diminish the estate.

The Fourth Circuit cites the late Professor Countryman for the premise that "the court must focus, not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have received less than a 100% payout in a Chapter 7 liquidation." *In re Virginia-Carolina Fin. Corp.*, 954 F.2d at 199. In turn, Professor Countryman looked to this Court's decision in *Palmer Clay Products Co. v. Brown*, 297 U.S. 227, 80 L. Ed. 655, 56 S. Ct. 450 (1936) for his analysis relied on by the Fourth Circuit. *See* Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713, 735-37 (1985) ("most courts have had no difficulty in reading section 547(b)(5) as incorporating the rule of Palmer Clay Products"); *Palmer Clay Products*, much like *Virginia-Carolina Financial Corporation* and *Swarts*, did not present a conflict between diminishment of the estate and the source of payment. *See generally Palmer Clay Products Co. v. Brown*, 297 U.S. 227, 80 L. Ed. 655, 56 S. Ct. 450 (1936). *Palmer Clay Products* involved a bilateral transaction where the source of the transfers was never a concern. *Id.* at 227-28. In fact, even attempting to use the language of the decision to reach the conclusion by the Fourth Circuit in this case requires a very creative reading of this Court's opinion. *See id.* at 229 ("Whether a creditor has received a preference is to be determined . . . by the actual effect of the payment as determined when bankruptcy results"). The primary issue in *Palmer Clay Products* was whether the analysis of preferential effect was to be made based upon the transfer date or the petition date. *Neuger v. United States (In re Tenna Corporation)*, 801 F.2d 819, 822 (6th Cir. 1986). The source of the alleged preferential payments was not an issue. *See id.*

A question in this case is whether diminution of the estate remains an element of § 547(b) of the Bankruptcy Code and whether the transfer must be compared only to payment as a general unsecured creditor in a direct distribution from the bankruptcy estate. The Sixth Circuit has declared that dimunition remains an element. The Fifth, Sixth, Seventh, Eighth Tenth and Eleventh Circuits similarly continue to apply the concept of diminishment of the estate to § 547(b). The Fourth and Ninth Circuits have found § 547(b) satisfied when the estate would not be diminished by the transfers. This Court should grant the writ of certiorari to resolve this confusion.

### B. The decision of the Fourth Circuit conflicts with decisions of the Fifth and Ninth Circuits that an indirect transfer that does not diminish the estate is a valid contemporaneous exchange for new value defense under 11 U.S.C. § 547(c)(1).

The Ninth Circuit considered a remarkably similar case to the current case and reached an opposite result in *O'Rourke v. Seaboard Surety Company (In re E.R. Fegert, Inc.)*, 887 F.2d 955 (9th Cir. 1989) (hereinafter cited as "*In re E.R. Fegert II*"). In the instant opinion, the Fourth Circuit wrote that it had reached its decision "without deciding the correctness of the *Fegert* court's conclusion that the release of the surety's security interest in that case constituted 'new value' contemporaneously received by the debtor." App. 13a. The opinion of the Fourth Circuit, however, does not draw any meaningful distinction between the Ninth Circuit's decision in *Fegert* and the instant case, which are in direct conflict.

In *Fegert*, the debtor contracted with the creditors for the construction of roads. 887 F.2d at 956. Pursuant to the requirements of the Miller Act, the debtor executed a payment bond for the protection of creditors. *Id.* The debtor defaulted on payments to the creditors, causing the creditors to file suits against both the debtor and the payment bond surety. *Id.* Prior to trial, both the surety and the debtor made payments to both creditors and the pending actions were dismissed. *Id.*

After the debtor filed bankruptcy, the trustee filed suit against the creditors seeking to avoid the payments from the debtor as preferential. *Id.* The bankruptcy court granted the creditors' motions for summary judgment based upon 11 U.S.C. § 547(c)(1). *O'Rourke v. Coral Construction, Inc. (In re E.R. Fegert, Inc.)* 88 B.R. 258, 259 (B.A.P. 9th Cir. 1988) (hereinafter cited as "*In re Fegert I*"). On appeal, the Bankruptcy Appellate Panel ultimately affirmed the bankruptcy court. *Id.* at 260. They reasoned that the allegedly preferential transfers released the *contingent* security interest in property of the estate held by the surety. *Id.* This constituted new value under 11 U.S.C. § 547(c)(1) that was released to the estate at the time of the transfers. *Id.*. The Ninth Circuit Court of Appeals affirmed the bankruptcy appellate panel on the same grounds. *In re E.R. Fegert II*, 887 F.2d at 959.

When compared with the current case, the factual similarities are striking. The creditors in *Fegert* and United Rentals in the instant case contracted with a construction contractor on specific construction projects. Both the creditors in *Fegert* and United Rentals in the instant case were valid claimants under payment bonds

executed by their debtors. Neither the creditors in *Fegert* nor United Rentals were paid the alleged preferential transfers by the surety. Both the creditors in *Fegert* and the current case were paid by the respective debtors, making payment from the surety unnecessary.

In reviewing the *Fegert* opinion, the Fourth Circuit explicitly noted that a surety does not have an equitable lien until such time as the surety pays the claimant. App. 12a. This is an accurate analysis of *Fegert*. Both opinions make clear that a surety's equitable lien arises *only* upon payment by the surety to the claimants.

The Fourth Circuit then determined that it need not decide the correctness of the Ninth Circuit's decision because of a factual difference in the cases that rendered them distinguishable. App. 13a. This distinction—in the words of the Fourth Circuit—is that the Ninth Circuit reached its conclusion because the allegedly preferential payments in that case caused the "release of the surety's security interest." App. 13a. This statement is shocking, because the Fourth Circuit previously stated that "[t]he Ninth Circuit reasoned that if the debtor had not paid the debt in full, the subcontractors would have been paid by the surety, which *then would have had an equitable lien* against the funds owed the debtor by the owner." App. 12a (emphasis added).

The Ninth Circuit Bankruptcy Appellate Panel in *Fegert I* was explicit in noting that the surety did not have a security interest in property of the estate because the surety had not paid the creditors. It wrote:

> In this case *the surety did not make the payments in question to the subcontractors.* Instead the payments were made pre-petition by the Debtor as part of a tripartite agreement under which the subcontractors released their claims against [the surety] in exchange for payments directly from the Debtor. Under these circumstances, *the Panel does not find that the fact that the surety did not actually make the payments to the subcontractors requires the application of a different equitable rule.* If the Debtor had not made the payments to [the creditors], then [the surety] would have been called upon to advance the funds and then exercise its lien rights against payments due or to become due to the Debtor.

*In re Fegert I*, 88 B.R. at 260 (emphasis added).

In both the instant case and *Fegert*, the surety did not have an equitable lien against the contract balance for the allegedly preferential transfers at the time of those transfers. Consequently, the purported factual distinction identified by the Fourth Circuit—that "the surety never obtained any lien it could release"—is actually a similarity. If the only relevant question is whether the surety actually possessed an equitable lien to be released at the time of the transfers, the outcome in both these cases would necessarily be the same. In contrast, the outcomes could not be more in conflict. The Fourth Circuit's decision in this case is a wholesale rejection of the *Fegert* decision.

In similar cases, both the Fifth and Ninth Circuits have affirmed the validity of the indirect transfer theory. These cases were both instances where the value of the third party security interest in the property of the estate was contingent upon the possible future enforcement of "mere contract claims" by the preference defendant against that third-party. In *Gulf Oil Corporation v. Fuel Oil Supply & Terminaling, Inc. (In re Fuel Oil Supply & Terminaling, Inc.)*, 837 F.2d 224 (5th Cir. 1988), the Fifth Circuit allowed a contemporaneous exchange defense when the preference defendant had *unsecured contract claims* against a third party bank. *See id.* at 229 (noting that the creditor could have drawn on letters of credit and that the bank had security rights in the debtor's assets based upon those letters of credit). The value of those security rights was contingent upon the preference defendant making a claim against the bank under the terms of the letter of credit. *Id.* The Fifth Circuit assumed that "[u]pon Bankruptcy, had [the debtor] not performed, the [preference defendant] would have drawn on the letters of credit and the Banks would have been entitled to the collateral or its value." *Id.* Because the estate was not diminished by the transfers, the court held that they could not be avoided as preferences. *Id.* at 230.

In *Powerine*, the Ninth Circuit came to the same result. There the court reasoned that there was an "automatic release of collateral."

> The Fifth Circuit held [in *In re Fuel Oil Supply & Terminaling, Inc.*] that the payment was protected by the contemporaneous exchange for new value exception, reasoning that, when

> the debtor paid the creditor, the banks' exposure under the letters of credit was reduced by a corresponding amount. The banks' *contingent* reimbursement claim against the debtor's assets was thereby released, *giving the debtor new value.* "This outcome is consistent with the principle underlying § 547(c)(1)," the Fifth Circuit noted, "*because the release of the debtor's collateral offsets the transfer to the creditor, thereby resulting in no depletion to the debtor's estate*"
>
> . . . When [the debtor] paid [the preference defendant] directly, [the bank's] exposure under the letters of credit was reduced by a corresponding amount, and its *contingent claim* against [the debtor's] assets *was thereby released*, but only to the extent the claim was secured. Thus, [the debtor] received new value equal to the amount of the secured portion of [the bank's] reimbursement claim.

*In re Powerine Oil Co.*, 59 F.3d at 973 (emphasis added).

Much like U.S. Fire's security interest in this case is contingent on U.S. Fire making payment on the payments bonds, in both *Fuel Oil Supply* and *Powerine* the value of the security interest released was contingent on payment by the third party. In all these cases, there never was a payment by the third party because the allegedly preferential payment intervened. Thus, the Fifth and Ninth Circuits have held that transfers which automatically released *mere contract rights* against a third party and caused the simultaneous

release of *contingent* security rights of that third party against assets of the estate were not preferential. The decision by the Fourth Circuit in the instant case is in conflict with these decisions by the Fifth and Ninth Circuits.

### C. The Fourth Circuit's decision is in conflict with decisions of this Court requiring deference to state courts' determinations of state created lien rights and in conflict with decisions of the Second and Ninth Circuits stating that transfers that release inchoate mechanic's lien rights are not preferential

In reviewing whether a lien created by state law is inchoate, this Court has traditionally accorded great deference to state courts. *See United States v. Security Trust & Savings Bank*, 340 U.S. 47, 49-50 (1950) ("if the state court itself describes the lien as inchoate, this classification is practically conclusive" (internal quotation marks omitted)). The North Carolina Supreme Court has on at least three occasions defined the materialmen and mechanic's liens created by North Carolina statute as "inchoate." *See Frank H. Conner Co. v. Spanish Inns Charlotte, Ltd.* 294 N.C. 661, 667 (1978) ("The lien provided for by G.S. 44A-8 is inchoate until perfected by compliance with G.S. 44A-11 and -12, and is lost if the steps required for its perfection are not taken in the manner and within the time prescribed by law"); *Nat'l Sur. Corp. v. Sharpe*, 236 N.C. 35, 48 (1952) ("G.S. 44-1 gives a contractor an inchoate lien upon a building and the lot on which it is situated"); *Equitable Life Assurance Soc'y v. Dunn*, 234 N.C. 347, 352 (1951) ("A contractor's lien on real property is

inchoate until perfected by compliance with legal requirements").

The Fourth Circuit held that United Rentals had only a "right to file a mechanic's lien," with the tacit implication that this "right" is something less than an inchoate lien. App. 16a. As a result, the Fourth Circuit's decision conflicts with the precedent of the North Carolina Supreme Court and ignores the deference to those decisions required by this Court.

This failure to adhere to this Court's precedent and the resulting mischaracterization of United Rentals inchoate liens allowed the Fourth Circuit to circumvent long existing precedent from other circuits. The Second and Ninth Circuits have held that transfer payments that automatically released inchoate mechanic's liens were not preferential. In *Ricotta v. Burns*, 264 F.2d 749 (2d Cir. 1959) as in the instant case, it was conceded that the defendant *could have* filed a mechanic's lien at the time each payment was made. The court noted that:

> neither the filing nor the enforcement of such a lien would have constituted a preference. Moreover, *had the liens been filed*, payment merely discharging them, without improving the creditor's position as against the general creditors of the bankrupt, would likewise have been immune from attack. *It would be absurd to treat differently payments for the same debts obtained without filing liens, and the law does not do so.* Consistent with common sense the courts have upheld payments where at the time the payments were made the

> creditor could have equally protected himself by filing a nonpreferential lien. . . .
>
> The sole purpose of filing these liens is to secure payment. *Surely receipt of payment itself should not be less secure than the lien which could have secured it.* Moreover, the essence of a preference is that it depletes the bankrupt's estate available to remaining creditors. *Where the payment merely avoids the bite of a lien which the trustee could not have successfully attacked, no such depletion occurs.*

*Id.* at 750 (emphasis added) (internal citations omitted).

In a later case, the Second Circuit reaffirmed this holding stating that "where a material man could have filed liens for building materials furnished the bankrupt and the filing or enforcement of the lien would not have constituted a preference, the court would treat payments for the debts *as if liens had been filed.*" *Miller v. Wells Fargo Bank International Corp.*, 540 F.2d 548, 565 (2d Cir. 1976) (emphasis added).

The Ninth Circuit has similarly held that a transfer made "in discharge of a California inchoate mechanic's lien may not be avoided by the Trustee as a preference." *Greenblatt v. Utley*, 240 F.2d 243, 244 (9th Cir. 1956). The court determined that the preference defendant held an inchoate lien at the time of the transfer, the "filing of which was not required by statute until some time [after the transfer]." *Id.* at 246. Since the time for perfecting defendant's lien had not expired, the

defendant accepted the payment "in satisfaction" of inchoate mechanic's lien right and payments were therefore not avoidable as a preference. *Id.* at 244-247.

The Fourth Circuit has rejected and is in conflict with these decisions of the Second and Ninth Circuits holding that there is no preferential transfer if unperfected state law inchoate mechanic's lien rights are released, resulting in no diminution of the estate.

## II. The decision below implicates a recurring question of national importance and conflicts with federal and state law

The Fourth Circuit has all but eliminated the protection provided to construction contractors by the federal Miller Act, state law Little Miller Acts or private payment bonds in the event of bankruptcy. A contractor who receives payment from their contract debtor is denied the protections of those statutes or bonds, if that contractor files bankruptcy within ninety days of making payment to their creditor. This result undermines the intent of those statutes and the important public interests that gave rise to their passage.

"The Miller Act was designed to provide an alternative remedy to the mechanics' liens ordinarily available on private construction projects." *J.W. Bateson Co., Inc. v. United States ex rel Board of trustees of the National Automatic Sprinkler Industry Pension Fund*, 434 U.S. 586, 589, 98 S. Ct. 873, 875, 55 L. Ed. 2d 50, 55 (1978); *see also F.D. Rich Co., Inc. v. United States ex rel Industrial Lumber Co., Inc.*, 417 U.S. 116, 122, 94 S. Ct. 2157, 2161, 40 L. Ed. 2d 703, 709 (1974) ("The

Miller Act was intended to provide an alternative remedy to protect the rights of these suppliers."). "The Miller Act . . . is highly remedial in nature." *United States ex rel Sherman v. Carter*, 353 U.S. 210, 216, 77 S. Ct. 793, 796, 1 L. Ed. 2d 776, 782 (1957). "It is entitled to a liberal construction and application in order properly to effectuate the Congressional intent to protect those whose labor and materials go into public projects." *Id.* The Act executes that policy by providing a surety who "must make good the obligations of a defaulting contractor to his suppliers of labor and material." *Id.* at 217. Similarly, state legislatures throughout the country have passed Little Miller Acts with the same intent.

In *Fegert*, the Ninth Circuit considered a contractor who could have collected on a Miller Act payment bond, but was instead paid by the contract debtor who later filed bankruptcy. There the court reached the common-sense conclusion that a creditor should not be prejudiced by its receipt of payment and thus be denied the protections of the Miller Act created by Congress to specifically protect contractors. *See In re E.R. Fegert II*, 887 F.2d at 959 (holding that the payments are not avoidable as preferences).

At least two circuits have held that the reasoning applied by this Court in *Pearlman* applies to non-Miller Act bonds as well. *First Indemnity of America Insurance Company v. Modular Structures, Inc. (In re Modular Structures, Inc.)*, 27 F.3d 72, 80 (3d Cir. 1994) ("There is also nothing in the Court's reasoning in *Pearlman* that implies that its doctrine should apply only to public contracts"); *Framingham Trust*

*Company v. Gould-National Batteries, Inc.*, 427 F.2d 856, 858 (1st Cir. 1970) ("We see no reason why that same equitable obligation to the laborers and materialmen should not exist on the part of the non-government owner, who receives the same benefit from those suppliers — construction work and materials — as did the government in the aforementioned cases.") The instant case does not directly involve a payment bond executed pursuant to the Miller Act or any Little Miller Act, but the reasoning involved is identical. The Fourth Circuit has decided, however, that § 547 eliminates the protection of a bond claimant creditor who received payment of the debt and as a result never made a bond claim, even if the creditor still had bond rights at the time of the transfer and even if the relevant owners and general contractors were holding sufficient funds at the time of the transfer that there was no diminution of the bankruptcy estate available for distribution to general unsecured creditors.

The decision of the Fourth Circuit flies directly in the face of the goals of the preference section of the Bankruptcy Code. These two goals, as expressed by the Fourth Circuit are to prevent companies from "racing to the courthouse to dismember the debtor during his slide into bankruptcy" and to "protect the equality of distribution among the creditors of the debtor." App. 3a (internal quotation marks omitted). The decision of the Fourth Circuit, however, requires construction creditors to race to the courthouse before they actually receive payment, if the creditor wishes to retain their payment bond or state law mechanic's lien rights.

The public policy ramifications of this decision are enormous. To protect themselves, any construction supplier or contractor would need to refuse payment and instead file mechanic's lien or bond claims as an ordinary practice to avoid bankruptcy preference claims, even if there is no reason to suspect an imminent bankruptcy. These mechanic's liens or bond claims would then be released on receipt of payment. This would disrupt projects and business relations, generate legal fees and consume court resources, while promoting, rather than preventing, dismemberment of the debtor during his slide into bankruptcy.

Paradoxically, a debtor that really wanted to avoid paying a certain lien or bond creditor could accomplish that end by *actually paying* the creditor right before bankruptcy.

> The Debtor/Contractor could, in effect, avoid payment of any or all subcontractors by paying them within 90 days of bankruptcy and then simply waiting until 60 days after substantial completion of the work before filing the action to recover the preference. By doing so, the subcontractor could effectively be denied its lien rights.

*In re Dick Henley, Inc.*, 38 B.R. 215 (Bankr. S.D.N.Y. 1984). The *Dick Henley* court recognized that the reasoning applied by the Fourth Circuit creates a legal framework that in reality is itself preferential.

Under the Fourth Circuit decision, an unpaid contractor is unquestionably better off than a paid contractor when a bankruptcy intervenes, where the payment bond or mechanic's lien rights could have been successfully enforced post bankruptcy petition. Consequently, contractors will be forced to take steps to protect their status, even when those actions defy common sense and threaten to wreak havoc on the construction industry. A decision with such clear and severe consequences warrants this Court's review.

## CONCLUSION

For the foregoing reasons, United Rentals, Inc., respectfully requests that the Court grant its petition for a writ of certiorari.

Respectfully submitted,

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# APPENDIX

## APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT DECIDED JANUARY 22, 2010

## UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 09-1209

UNITED RENTALS, INCORPORATED,

*Plaintiff-Appellant*,

v.

JAMES BIGELOW ANGELL,

*Trustee-Appellee*.

Appeal from the United States District Court
for the Eastern District of North Carolina, at Raleigh.
Terrence W. Boyle, District Judge.
(7:08-cv-00097-BO)

Argued: December 2, 2009

Decided: January 22, 2010

Before TRAXLER, Chief Judge, and SHEDD and DAVIS, Circuit Judges.

*Appendix A*

## OPINION

TRAXLER , Chief Judge:

United Rentals, Inc. ("United") appeals a district court order affirming a bankruptcy court judgment allowing the bankruptcy trustee to avoid and recover certain payments made to United during the 90 days prior to the bankruptcy petition. We affirm.

I.

Partitions Plus of Wilmington, Inc. ("the Debtor") filed a Chapter 11 bankruptcy petition on September 1, 2004. The case was subsequently converted to a Chapter 7 proceeding. Prior to its bankruptcy filing, the Debtor had subcontracted in several construction projects, and United had subcontracted with the Debtor to supply rental equipment. The Debtor executed payment and performance bonds with United States Fire Insurance Company ("the Surety"), for the construction of several of these projects.

In the 90-day period prior to the Debtor's bankruptcy filing, the Debtor made three payments to United totaling $ 75,849.40 for amounts owed for United's prior provision of rental equipment and parts ("the transfers"), $ 67,470.60 of which was for bonded projects. The bankruptcy trustee ("the Trustee") filed this action seeking to avoid and recover the transfers as preferential payments. *See* 11 U.S.C.A. § 547(b) (West 2004 & Supp. 2009). United denied that the transfers

were avoidable and asserted defenses under 11 U.S.C.A. § 547(c)(1), (3), and (4) (West 2004 & Supp. 2009).

The Bankruptcy Code's preference section serves two goals. First, it prevents companies from "racing to the courthouse to dismember the debtor during his slide into bankruptcy." *Harman v. First Am. Bank of Md. (In re Jeffrey Bigelow Design Group, Inc.)*, 956 F.2d 479, 487 (4th Cir. 1992) (internal quotation marks omitted). And second, it protects "equality of distribution among creditors of the debtor." *Id.* (internal quotation marks omitted). Except as specified in the Bankruptcy Code, a bankruptcy trustee may avoid as a preference a transfer made by an insolvent debtor to a creditor on account of an antecedent debt within 90 days before the date of the filing of the bankruptcy petition if a certain condition is satisfied.[1] *See* 11 U.S.C.A. § 547(b). That condition is that the transfer to be avoided must have enabled the creditor to receive more than it would have received from the debtor's Chapter 7 bankruptcy on the debt the transfer extinguished if the payment sought to be avoided had never been made. *See* 11 U.S.C.A. § 547(b)(5).

Section 547(c) provides exceptions for certain preferential transfers, the avoidance of which would not further the purposes of § 547(b). Section 547(c)(1) provides that a transfer cannot be avoided "to the extent [it] was . . . intended by the debtor and the creditor to

1. Unsecured creditors may then share in any avoided payments on a pro rata basis.

or for whose benefit [it] was made to be a contemporaneous exchange for new value given to the debtor; and [it] in fact [was] a substantially contemporaneous exchange." 11 U.S.C.A. § 547(c)(1). The purpose of the § 547(c)(1) exception is "to encourage creditors to continue to deal with troubled debtors without fear that they will have to disgorge payments received for value given." *Collier on Bankruptcy* ¶ 547.04 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009). As its legislative history demonstrates, § 547(c)(1) was designed to address the "generic problem [that] those on the verge of bankruptcy still need to buy things . . . and the fact that checks are used (with a brief gap between purchase and payment) ought not render the payment avoidable as one made for an antecedent debt." *Collins v. Greater Atl. Mortgage Corp. (In re Lazarus)*, 478 F.3d 12, 18 (1st Cir. 2007) (citing H.R. Rep. No. 95-595, at 373 (1977)); *see Batlan v. TransAmerica Commercial Fin. Corp. (In re Smith's Home Furnishings, Inc.)*, 265 F.3d 959, 965 n.4 (9th Cir. 2001) (explaining that § 547(c)(1) "was designed to prevent trustees from avoiding payments that were clearly intended to support a new transaction, instead of an antecedent debt, even though the actual payment was not recorded until after the transaction"). Protecting contemporaneous exchanges for new value from avoidance does not harm the preference section's goal of protecting the equality of distribution among the debtors because such exchanges do not diminish the size of the debtor's estate. *See Jones Truck Lines, Inc. v. Cent. States, Se. & Sw. Areas Pension Fund (In re Jones Truck Lines)*, 130 F.3d 323, 326 (8th Cir. 1997).

*Appendix A*

The Trustee moved for partial summary judgment on the issue of whether the transfers satisfied the § 547(b) requirements, and United moved for summary judgment. The Trustee argued that it had established all of the § 547(b) elements as a matter of law. As is relevant here, United responded that the Trustee could not establish that the transfers were preferences under § 547(b) because the transferred funds were not property of the estate. United also argued that the Trustee could not satisfy § 547(b)(5) with regard to the transfers because United would have received full payment from the Surety by enforcing its bond rights had the Debtor not made the transfers.

United further contended that the § 547(c)(1) defense applied because the transfers had the effect of discharging United's right to file and enforce a mechanic's lien. United finally maintained that certain payments from the Debtor to United were in exchange for new value in the form of credit extended to the Debtor after the transferred funds were received.

Considering the parties' cross-motions, the bankruptcy court ruled as a matter of law that the Trustee met its burden of establishing that the transfers were preferences under § 547(b). Regarding United's argument that had the challenged transfers not been made, United still would have received full payment from the bond, the court reasoned that the critical question with regard to § 547(b)(5) was not whether the creditor would have received payment from *another source* had the challenged transfer not been made, but rather,

whether it would have received payment from the Chapter 7 bankruptcy estate. As for United's new-value defense, the bankruptcy court noted that the Trustee did not dispute United's assertion that some payments made to the Debtor were in exchange for credit that United extended to the Debtor after the transferred funds were received. The bankruptcy court thus ruled that United was "entitled to a minimum credit of $8885.66 based on new value, and it has the right to try to increase that amount upon an appropriate showing at trial." J.A. 179.

The case then proceeded to trial regarding United's § 547(c)(1) defense. United sought to prove that the transfers were substantially contemporaneous exchanges for new value because they extinguished United's rights to file and enforce a lien as well as its rights to obtain payment through the bond. The bankruptcy court found that the § 547(c)(1) defense was not established because the discharge of United's inchoate lien rights and bond rights did not constitute new value. The court noted that United had not perfected any lien or security interest in property to secure the Debtor's debt and thus had no interest to release in exchange for the transfers. The court ruled that to establish the § 547(c)(1) defense with regard to its inchoate lien and bond rights, United would have to prove that it would have timely enforced these rights and been paid in full had the challenged transfers not been made, and that at that time the Debtor was still owed funds by the general contractor on which the Surety could have asserted a lien. Concluding that

United failed to establish the former point, the court ruled that the Trustee was entitled to recover the remainder of the challenged transfers—$ 66,963.74—for the benefit of the bankruptcy estate. United then appealed to the district court, which affirmed the bankruptcy court judgment.

II.

United argues that the bankruptcy court erred in granting partial summary judgment against it regarding whether the transfers were preferences under § 547(b). We find no reversible error.

We review a grant of partial summary judgment by the bankruptcy court and the affirmance thereof by the district court de novo. *See Bank of N.Y. v. Treco (In re Treco)*, 240 F.3d 148, 155 (2d Cir. 2001). Summary judgment in bankruptcy is governed by Federal Rule of Bankruptcy Procedure 7056, which incorporates the standards of Federal Rule of Civil Procedure 56 into bankruptcy proceedings. *See* Fed. R. Bankr. P. 7056; Fed. R. Civ. P. 56. Thus, in reviewing a grant of partial summary judgment, we view the facts and the reasonable inferences drawn therefrom in the light most favorable to the nonmoving party. *See EEOC v. Navy Fed. Credit Union*, 424 F.3d 397, 405 (4th Cir. 2005). Partial summary judgment is appropriate "if there is no genuine issue of material fact and the moving party is entitled to a judgment as a matter of law." *Cline v. Wal Mart Stores, Inc.*, 144 F.3d 294, 300 (4th Cir. 1998).

*Appendix A*

Section 547(b) states:

> Except as provided in [11 U.S.C.A. § 547(c) and (i)], the trustee may avoid any interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) *that enables such creditor to receive more than such creditor would receive if—*
>
> *(A) the case were a case under chapter 7 of this title;*
>
> *(B) the transfer had not been made; and*

> *(C) such creditor received payment of such debt to the extent provided by the provisions of this title.*

11 U.S.C.A. § 547(b) (emphasis added); *see Morrison v. Champion Credit Corp. (In re Barefoot)*, 952 F.2d 795, 798 (4th Cir. 1991). The bankruptcy trustee bears the burden of proving that a transfer is avoidable under § 547(b). *See* 11 U.S.C.A. § 547(g) (West 2004).

United contends that the bankruptcy court erred in concluding at the summary judgment stage that the Trustee had established the fifth § 547(b) requirement as a matter of law. This is so, United argues, because had the transfers not been made, United could have received full payment from the Surety by enforcing its bond rights.[2] The bankruptcy court properly rejected this argument, however. The § 547(b)(5) inquiry focuses "not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have received less than a 100% payout" from the

2. United similarly argues that the court's resolution of the § 547(b) issue at the summary judgment stage was improper because the Trustee failed to show as a matter of law that, had the transfers not been made, United would not have obtained full payment from the hypothetical Chapter 7 estate by enforcing its lien rights and thereby attaining secured-creditor status. Because this argument is raised for the first time on appeal, we do not address it. *See Williams v. Prof'l Transp. Inc.*, 294 F.3d 607, 614 (4th Cir. 2002) ("Issues raised for the first time on appeal are generally not considered absent exceptional circumstances.").

bankruptcy estate. *Smith v. Creative-Financial Mgmt., Inc., (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193, 199 (4th Cir. 1992).

III.

United next argues that the district court erred in finding that it did not establish a § 547(c)(1) defense at trial.[3] We disagree.

A.

We review the district court decision de novo, "effectively standing in its shoes to consider directly the findings of fact and conclusions of law by the bankruptcy court." *Cypher Chiropractic Ctr. v. Runski (In re Runski)*, 102 F.3d 744, 745 (4th Cir. 1996). "[W]e review legal conclusions by the bankruptcy court de novo and may overturn its factual determinations only upon a showing of clear error." *Id.*

The party against whom recovery or avoidance is sought bears the burden of proving a § 547(c) defense. *See* 11 U.S.C.A. § 547(g). As we have explained, § 547(c)(1) prevents a bankruptcy trustee from avoiding a transfer "to the extent [it] was . . . intended by the debtor and the creditor to or for whose benefit [it] was

3. United also argues that it established a defense under 11 U.S.C.A. § 547(c)(6). Because this argument is raised for the first time on appeal, we do not consider it. *See Williams*, 294 F.3d at 614.

made to be a contemporaneous exchange for new value given to the debtor; and [it] in fact [was] a substantially contemporaneous exchange." 11 U.S.C.A. § 547(c)(1). The Bankruptcy Code defines "new value" to mean

> money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property.

11 U.S.C.A. § 547(a)(2) (West 2004). "New value," however, "does not include an obligation substituted for an existing obligation." *Id.*

B.

United argues that it established a § 547(c)(1) defense under the "indirect transfer theory." In this regard, United first contends that had the Debtor not made the transfers, United nonetheless could have obtained full payment by enforcing its bond rights. United maintains that had the Surety paid such a claim under the bond, the Surety would have automatically received an equitable lien by subrogation against the funds the general contractor owed the Debtor. Relying on *O'Rourke v. Seaboard Surety Co. (In re E.R. Fegert, Inc.)*, 887 F.2d 955 (9th Cir. 1989) ("*Fegert*"), United argues that the money that the Debtor was eventually paid (that the Surety could have obtained directly from

the general contractor had United enforced its bond rights) constituted new value to the Debtor for purposes of § 547(c)(1).

In *Fegert*, a general contractor ("the debtor") defaulted on its payments to two subcontractors. *See Fegert*, 887 F.2d at 956. The subcontractors, in turn, sued the debtor and the surety that had issued a payment and performance bond on the debtor's behalf. *See Fegert*, 887 F.2d at 956. Prior to trial, the debtor and the surety made payments to the subcontractors that, when combined, satisfied the debt and resulted in dismissal of the suit. *See id.* Within 90 days of these payments, the debtor filed a Chapter 11 bankruptcy petition that was later converted to a Chapter 7 proceeding. *See id.* In a subsequent adversary proceeding, the bankruptcy trustee sought to avoid the payments from the debtor as preferential. *See id.* The bankruptcy court granted summary judgment against the trustee, and the Bankruptcy Appellate Panel and the Ninth Circuit affirmed. *See id.* at 956-57. The Ninth Circuit reasoned that if the debtor had not paid the debt in full, the subcontractors would have been paid by the surety, which then would have had an equitable lien against the funds owed the debtor by the owner. *See id.* at 958-59. The court noted that "[t]wo circuits have held that payments by a debtor in exchange for a secured creditor's release of its security interest falls within the exception of section 547(c)(1)." *Id.* at 959 (citing *Gulf Oil Corp. v. Fuel Oil Supply & Terminaling, Inc. (In re Fuel Oil Supply & Terminaling, Inc.)*, 837 F.2d 224, 229-30 (5th Cir. 1988), and *Kenan v. Fort Worth Pipe*

*Co. (In re George Rodman, Inc.)*, 792 F.2d 125, 127 (10th Cir. 1986)). The court therefore held that "[t]he security interest constitutes the 'new value' that is 'contemporaneously exchanged'" and noted that "the value of the debtor's estate is not diminished." *Id.*

Without deciding the correctness of the *Fegert* court's conclusion that the release of the surety's security interest in that case constituted "new value" contemporaneously received by the debtor, we conclude that that was not the case on the facts before us. Since United never even attempted to make any claim on the bond here, the Surety never obtained any lien that it could release. It is therefore not surprising that United does not even argue to us that the Debtor received new value by virtue of the removal of the possibility that any such lien would ever be created.

What United does argue is that new value was given to the Debtor in the form of the *money* that it eventually received from the general contractors that might have instead been paid to the Surety had the Surety paid a bond claim. This argument does not work. Even if the money the Debtor paid to United in the transfers was eventually offset by the Debtor's later receipt of funds that the Surety might otherwise have claimed, United has not shown when the Debtor received this "new value." Accordingly, regardless of whether the transfers set in motion a chain of events that resulted in the Debtor's recoupment of the amounts paid, United did not show that such new value was "'given to the debtor' . . . as part of a 'contemporaneous exchange.'"

*Appendix A*

*Baker Hughes Oilfield Operations, Inc. v. Cage (In re Ramba, Inc.)*, 416 F.3d 394, 399-400 (5th Cir. 2005) ("[I]t is the precise benefit received . . ., and not the secondary or tertiary effects thereof, that must fit within one of the five categories of 'new value' . . . enumerated in § 547(a)(2)."). In this case, the only benefit that United showed the Debtor was given as part of the contemporaneous exchange for the transfers was the extinguishment of its debt, which does not fit within any of the five new-value categories.

Furthermore, even assuming *arguendo* that the transfers were part of a contemporaneous exchange for new value, United produced no evidence that the Debtor and United *intended* that would be the case. United failed to produce evidence that the parties viewed this transaction as anything more than the payment of the debt of an as-yet unsecured creditor; no evidence demonstrated when the parties believed the Debtor might recoup some of the transferred funds or even that they believed any funds would be recouped.

C.

Similar to its argument that it could have pursued payment from the Surety, United contends that had the transfers not been made, it also could have pursued its right to file a North Carolina mechanic's lien on the real property improved by one of the construction projects. To the extent that United maintains that the new value given to the Debtor was money—the money it retained by not having to face offset claims that the property

owner would have gained from United's enforcement of its lien rights—the argument fails for the same reasons we have discussed regarding its bond argument. United argues, however, that the discharge of United's inchoate lien rights themselves constitutes new value, independent of any financial benefit the Debtor received from the discharge. In particular, United claims that it held a security interest in the owners' properties at the time of the transfers (and thus "had property previously transferred," 11 U.S.C.A. § 547(a)(2)) because the mechanic's lien statutes immediately grant a security interest to a supplier who furnishes labor or material to improve the property. The Code's definition of "transfer" indeed includes "the creation of a lien." 11 U.S.C. § 101(54)(A) (West Supp. 2009). However, just as the Surety did not have an equitable lien to release since it had not paid a claim on the bond, United did not have a security interest to release because it never filed the mechanic's lien claim necessary to obtain such an interest.

Under North Carolina law, a person who improves real property, including by providing rental equipment pursuant to a contract with the owner, "shall, upon complying with the provisions of this Article, have a right to file a claim of lien on real property [also known as a mechanic's lien] on the real property to secure payment of all debts owing for" rented equipment. N.C. Gen. Stat. § 44A-8 (2009); *see also* N.C. Gen. Stat. § 44A-12 (2009) (providing the place, time, and contents of the filing required for a mechanic's lien). Such a lien "shall relate to and take effect from the time of the first furnishing

of labor or materials at the site of the improvement by the person claiming the claim of lien on real property." N.C. Gen. Stat. § 44A-10 (2009).

A first-, second-, or third-tier subcontractor who has furnished rental equipment in the improvement of real property, upon compliance with certain requirements, may also enforce the contractor's lien on real property. *See* N.C. Gen. Stat. § 44A-23 (2009). Once a subcontractor has filed a lien, it may enforce the lien within 180 days after the last furnishing of labor or materials to the real property by filing a lawsuit. *See* N.C. Gen. Stat. § 44A-13 (2009). A mechanic's lien is discharged by failure to enforce the claim of lien within the prescribed time. *See* N.C. Gen. Stat. § 44A-16(3) (2009).

As we have explained, United claims that it held a security interest in the owners' properties at the time of the transfers because the mechanic's lien statutes immediately grant a security interest to a supplier who furnishes labor or material to improve the property. United bases this argument on the notion that a mechanic's lien, once filed, is retroactively effective to the time the material or labor were furnished. United's conclusion does not follow from its premise, however. North Carolina's mechanic's lien statutes grant a supplier of labor or material only *the right to file a mechanic's lien*, which United did not do here. *See* N.C. Gen. Stat. § 44A-8 ("Any person who . . . furnishes rental equipment . . . shall, upon complying with the provisions of this Article, have *a right to file a claim of lien* on real property." (emphasis added)). Only upon the filing of a

claim for a mechanic's lien is the owner's property encumbered. *See* N.C. Gen. Stat. § 44A-10 ("*A claim of lien* on real property granted by this Article shall relate to and take effect from the time of the first furnishing of labor or materials at the site of the improvement by the person claiming the claim of lien on real property" (emphasis added)). Because United had not filed such a claim when the transfers were made, no interest had been transferred to United and United had no such interest to release.[4]

United argues that it would not make sense from a policy standpoint to force a subcontractor in United's position to refuse tendered payments and file a mechanic's lien. But it does not necessarily follow from our holding that subcontractors would need to take that course. Indeed, United argues in this very appeal that the Trustee, in order to prove that the transfers were even preferences under § 547(b), should have been required to show that had the transfers not been made, United would not have promptly filed lien claims and thereby attained secured creditor status such that it could have obtained full payment in a hypothetical Chapter 7 bankruptcy. Whether United's argument is correct is an issue that will have to wait for another case in which the issue is properly preserved. *See supra*, at 7 n.2 (explaining that we do not address this argument because United raised it for the first time on appeal).

4. United argues that *McCoy v. Wood*, 70 N.C. 125 (1874), is to the contrary. However, as United concedes, *McCoy* did not interpret the mechanic's lien statutes at issue here. Indeed, the mechanic's lien statutes considered in *McCoy* did not have comparable wording to those before us now.

*Appendix A*

Our holding today is limited to the conclusion that United did not establish the § 547(c)(1) defense beyond the amounts determined by the bankruptcy court at the summary judgment stage. This holding makes perfect sense when viewed in the context of § 547(c)(1)'s purpose, to accommodate the need of financially unsteady companies to use checks to pay for new transactions. *See In re Lazarus*, 478 F.3d at 18; *In re Smith's Home Furnishings, Inc.*, 265 F.3d at 965 n.4. The facts of this case, wherein the transfers were not made substantially contemporaneously with United's supplying of the equipment and parts that generated the debt, present a completely different scenario.

IV.

For the foregoing reasons, we affirm the district court order affirming the bankruptcy court judgment in favor of the Trustee.

*AFFIRMED*

## APPENDIX B — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA, SOUTHERN DIVISION DATED JANUARY 22, 2009

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF**
**NORTH CAROLINA**
**SOUTHERN DIVISION**

No. 7:08-CV-97-BO

UNITED RENTALS, INC.,

Appellant,

v.

JAMES B. ANGELL, Chapter 7 trustee for Partitions Plus of Wilmington, Inc. D/B/A Partitions, Inc., D/B/A Storm Protections Systems,

Appellee.

### ORDER

This matter is before the Court on United Rentals, Inc.'s ("Appellant") appeal from Bankruptcy Court. The issues on appeal are: (1) whether the Bankruptcy Court properly granted summary judgment for Appellee for Appellee's 11 U.S.C. § 547(b) claims; and (2) whether the Bankruptcy Court properly granted judgment for Appellee in finding that transfers to the Appellant were only subject to the new value defense under 11 U.S.C.

§ 541(c)(1) in the amount of $8,885.66. For the reasons stated below, the Bankruptcy Court's decision is AFFIRMED.

## I. *SUMMARY OF THE INSTANT DISPUTE*

Partitions Plus of Wilmington, Inc. ("Partitions Plus") filed a Chapter 11 bankruptcy petition on September 1, 2004. On November 9, 2004, the case was converted to a Chapter 7 bankruptcy proceeding and James B. Angell ("Appellee") was appointed trustee for Partitions Plus. On July 14, 2006, Trustee filed a complaint, alleging that Partitions Plus made preferential transfers to Appellant in the amount of $75,849.40 and that these transfers were avoidable pursuant to 11 U.S.C. § 547(b) and recoverable under 11 U.S.C. § 550(a).

The Bankruptcy Court produced three separate orders in this case: one on June 14, 2007, one on March 31, 2008, and one on April 30, 2008. In the first order, the Bankruptcy Court held that Appellee had established that the payments in question constituted preferential payments and that Appellant was entitled to a minimum credit of $8,885.66 based on its new value defense. The actual amount of the credit was to be determined at another date. In the second order, the Bankruptcy Court held that Appellee was entitled to recover $66,963.74 in preferential payments from Appellant, effectively ruling on the amount of credit Appellant received. This order did not mention prejudgment interest.

*Appendix B*

In the third order, the Bankruptcy Court ruled that Angell was entitled to recover prejudgment interest at the rate of 4.89% per annum from May 16, 2006, until April 30, 2008, and denied Appellant's motions to stay. On May 9, 2008, Appellant appealed from this decision. This appeal is now ripe for ruling.

## II. *DISCUSSION*

The District Court has jurisdiction to hear appeals from final judgments, orders, and decrees entered in cases and proceedings of the Bankruptcy Court. 28 U.S.C. § 158(a)(1) (2008). An appeal from the Bankruptcy Court shall be taken by the District Court if filed within the time allowed by Fed. R. Bankr. P. 8002. On appeal from a final decision of a Bankruptcy Court, the District Court acts as an appellate tribunal, reviewing findings of fact for clear error and conclusions of law *de novo*. *Butler v. David Shaw, Inc.*, 72 F.3d 437, 440 (4th Cir. 1996).

Under 11 U.S.C. § 547(b), a trustee may avoid any transfer of the debtor's interest in property if the transfers: (1) were to or for the benefit of a creditor; (2) were for or on account of antecedent debts; (3) were made while the debtor was insolvent; (4) were made on or within ninety (90) days before the debtor field bankruptcy; and (5) enabled the defendant to receive more than he would have received if the transfers had not been made. The trustee has the burden of proving the avoidability of the transfer(s). 11 U.S.C. § 547(g).

A preferential transfer may not be avoided, however, "to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—(A) not secured by an otherwise unavoidable security interest; and (B) on account of which new value of the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor." 11 U.S.C. § 547(c)(4).

Appellant does not contest that the first four elements of a preferential transfer are met. Thus, the issues before the Court are: (1) what portion, if any, Partitions Plus had interest in; (2) whether the transfers enabled Appellant to receive more than it would have if the transfers had not been made; and (3) whether Appellant gave new value to Partitions Plus after a transfer was made. Each of these issues is addressed below.

### A. Partitions Plus had interest in all of the transferred property.

Appellant argued that: (1) the General Agreement of Indemnity ("GAI") entered into between US Fire and Partitions Plus created an express trust, which meant that the monies paid to Appellant were not the property of Partitions Plus; and (2) Appellant had an equitable lien in the transferred funds received from Partitions Plus on account of equipment supplied by Appellant on construction projects.

First, no express trust was created because the trust fund assets were commingled with non-trust assets, which "by itself is fatal" to the claim of an express trust. *Harleysville Worcester Mutual Ins. Co. v. Fleet Nat'l Bank (In re Suprema Specialties, Inc.)*, 2007 U.S. Dist. LEXIS 33937, at *35 (S.D.N.Y. May 7, 2007) (citing *Agudas Chasidei Chabad v. Gouray*, 833 F.2d 431 (2d Cir. 1987).[1]

Second, Appellant incorrectly bases its argument that it had an equitable lien in the transferred funds on the expansion of the Supreme Court's analysis of a surety's subrogation rights in *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132 (1962),[2] to an unpaid subcontractor's rights. However, as noted by the Bankruptcy Court, such analysis was rejected by the Fourth Circuit in *Grochal v. Ocean Technical Servs. Corp. (In re Baltimore Marine Indus.)*, 476 F.3d 238, 241-42 (4th Cir. 2007) (holding that surety who has fully paid all subcontractors has a greater right to retained funds than that of an unpaid subcontractor).

Thus, Partitions Plus had an interest in all of the transferred property.

1. Note that the parties had a choice of law provision in which they agreed that New York law would be applied.

2. A "surety, having paid the laborers and materialmen, is entitled to the benefit of all these rights to the extent necessary to reimburse it." *Pearlman*, 371 U.S. at 141.

**B. Appellant received more than it would have if the transfers had not occurred.**

Appellant's claim that it would have received payment in full by filing a claim against Partitions Plus is contradicted by the evidence. "[T]he court must focus, not on whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead upon whether the creditor would have received less than a 100% payout in Chapter 7 liquidation." *Smith v. Creative Financial Mgmt, Inc. (In re Virginia-Carolina Fin. Corp.)*, 954 F.2d 193, 199 (4th Cir. 1992). Appellee submitted affidavits which proved that there were inadequate funds to provide a payout in full to unsecured creditors. Appellant, as an unsecured creditor,[3] would not have received payment in full had the debtor not provided it. Thus, Appellant received more than it would have if the transfers had not been made.

**C. The Bankruptcy Court appropriately determined the extent to which Appellant could recover under the new value defense.**

While it is undisputed that Appellant is entitled to some credit against the amount of preferential payments for subsequent advances of new value pursuant to 11 U.S.C. § 547(c)(4), the Bankruptcy Court correctly

3. Appellant is an unsecured creditor because it failed to file notice. *See* N.C. Gen. Stat. § 44A-18(6); *see also Precision Walls v Crampton (In re Precision Walls)*, 196 B.R. 299 (E.D.N.C. 1996).

restricted this amount to the uncontested amount of credit Appellant extended to Partitions Plus. Appellant, as the creditor or party in interest against whom recovery or avoidance is sought, has the burden of proving the non-avoidability of the transfer. 11 U.S.C. § 547(g). "New value" includes "money or money's worth in goods, services, or new credit." 11 U.S.C. § 547(a)(2). In order to prevail on a new value defense using an "indirect transfer" theory in a case involving a subcontractor's release of a potential bond claim, the creditor must show: (1) that it would have timely filed a claim against the project's payment bond and been paid in full had it not received payment from the debtor; and (2) that, at the time, the debtor was still owed funds by the general contractor on which the bonding company would have asserted a lien. *Angell v. Pennington et al.*, Adv. Pro. 06-00148-8-AP, at *5-6 (Bankr. E.D.N.C. March 20, 2008).

Appellant presented no evidence to the Bankruptcy Court that it would have filed a claim and been paid in full had it not received payment from Appellee. Appellant admits that it had not filed a claim against Appellee prior to Appellee filing suit, despite the fact that Appellee owed it money at the time Appellee initially filed suit. Appellant further failed to produce any evidence of its practice of filing claims. Even if Appellant had filed a claim, Partitions Plus would not have been capable of paying it in full because, as noted above, it did not have the finances to fully pay off the unsecured creditors. Therefore, the Bankruptcy Court correctly determined that Appellant established its new value defense only to the extent of the uncontested amount of credit: $8,885.66.

## III. *CONCLUSION*

This Court AFFIRMS the Bankruptcy Court's decision that Appellee satisfied its burden of establishing that preferential payments were made to Appellant and that Appellant only established its new value defense to the extent of the uncontested amount of credit.

SO ORDERED, this 22 day of January 2009.

s/ Terrence W. Boyle
TERRENCE W. BOYLE
UNITED STATES DISTRICT JUDGE

## APPENDIX C — AMENDED JUDGMENT ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA, WILMINGTON DIVISION DATED APRIL 30, 2008

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF
NORTH CAROLINA
WILMINGTON DIVISION

Case No. 04-06776-8-JRL
Chapter 7

Adversary Proceeding
No. 06-00152-8-AP

IN RE:

PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Debtor.

JAMES B. ANGELL, CHAPTER 7 TRUSTEE FOR PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Plaintiff,

v.

UNITED RENTALS, INC.,

Defendant.

*Appendix C*

## ORDER

This case is before the court on a motion by James B. Angell, chapter 7 trustee for Partitions Plus of Wilmington, Inc., to alter or amend the judgment to include an award of prejudgment interest, and two motions by United Rentals, Inc.: the first to stay the judgment pending disposition of the trustee's motion to alter or amend the judgment, and the second to stay the judgment pending appeal.

I. Trustee's Motion to Alter or Amend Judgment

After conducting a trial in this adversary proceeding, the court entered an order on March 31, 2008, finding that the trustee was entitled to recover $66,963.74 in preferential payments from United Rentals. The clerk entered judgment accordingly. On April 4, 2008, the trustee filed a motion pursuant to Fed. R. Bankr. P. 9023 and Fed. R. Civ. P. 59(e) to alter or amend the judgment to include an award of prejudgment interest. The trustee's motion argues that prejudgment interest is appropriate from the date of demand of the return of the preference. In opposition to the trustee's motion, United Rentals argues that (1) there are no grounds to justify amending the judgment, (2) prejudgment interest is inappropriate where the amount the estate is entitled to recover is not determined until trial, and (3) the trustee presented no evidence to substantiate a claim for prejudgment interest.

*Appendix C*

"It is well settled that bankruptcy courts have discretion to award prejudgment interest in § 547 preferential transfers actions, and to compute that interest from the date of demand for the return of the transferred funds. *Sigmon v. Royal Cake Co. (In re Cybermech, Inc.)*, 13 F3d 818, 822 (4th Cir. 1994). A prejudgment interest award "serves to 'compensate the debtor's estate for [the defendant's] use of those funds that were wrongfully withheld from the debtor's estate during the pendency of the [litigation].'" *Id.* (quoting *In re Investment Bankers, Inc.*, 4 F3d 1556, 1566 (10th Cir. 1993)).

United Rentals first argues that the court's order implicitly denied prejudgment interest, and that the trustee's mere disagreement with the denial of prejudgment interest does not present one of the three circumstances identified by the Fourth Circuit as justifying Rule 59(e) relief. Although United Rentals reads the court's order as denying an award of prejudgment interest, omission of that issue was purely a matter of inadvertence rather than deliberate consideration. Therefore, the trustee does not seek reconsideration of that issue, but rather presents the issue for resolution in the first instance.

United Rentals's argument proceeds on the theory that the trustee does not present an issue that justifies relief under Rule 59(e). Although the authority cited by United Rentals suggests that there are three grounds for amending an earlier judgment pursuant to Rule 59(e), *see Pacific Ins. Co. v. American Nat. Fire Ins.*

*Co.*, 148 F.3d 396, 403 (4th Cir. 1998), nothing in that precedent suggests that there are *only* three grounds for relief under Rule 59(e). In fact, the Supreme Court has specifically found that a postjudgment motion for discretionary prejudgment interest clearly falls under Rule 59(e). *Osterneck v. Ernst & Whinney*, 489 U.S. 169 (1989). Further, "if the district court's original judgment did not mention an award of prejudgment and postjudgment interest, [a postjudgment motion for discretionary prejudgment interest] clearly would be governed by *Osterneck* . . . ." *Kosnoski v. Howley*, 33 F.3d 376, 378 (4th Cir. 1994). Because the March 31, 2008 order did not address the issue of prejudgment interest, the trustee's motion sets forth a cognizable basis for relief under Rule 59(e).

United Rentals's second argument is that the trustee is not entitled to prejudgment interest because the amount of damages was undetermined until judgment. Citing precedent approving this principle, United Rentals argues that damages were undetermined in this case because its liability could have been reduced or completely eliminated by its new value defense. United Rentals cites several cases in support of this proposition, including *In re Investment Bankers, Inc.*, 4 F.3d 1556, 1566 (10th Cir. 1993), and *In re Bellanca Aircraft, Corp.*, 850 F.2d 1275, 1281 (8th Cir. 1988). However, the precedent relied on by these cases is more concerned with a party's inability to calculate damages with a mathematical certainty at the outset of the case, such as in personal injury and wrongful death actions, rather than the possibility that a damage claim

for a specified amount may be reduced by an affirmative defense. Accepting United Rentals's argument would effectively eliminate the possibility of a prejudgment interest award in preference actions involving an affirmative defense. The trustee's complaint requested a specific damage figure, and the possibility that United Rentals could have offset that amount by establishing a new value defense does not prevent an award of prejudgment interest. *See Precision Walls v. Crampton*, 196 B.R. 299 (E.D.N.C. 1996) (affirming prejudgment interest award in a preference action where trustee received less than amount sought in complaint).

United Rentals's final argument is that the trustee is not entitled to prejudgment interest because he produced no evidence of the basis for, or the amount of, a prejudgment interest claim. The fundamental flaw with this argument is that no evidence was necessary because the parties agreed to the only disputable element of the trustee's claim for prejudgment interest. The issue of liability aside, the only elements necessary to determine a proper award of prejudgment interest are (1) the interest rate, and (2) the date on which the interest runs. Of these two elements, only the date on which the interest begins to run may be seriously disputed.[1] A trustee is "entitled . . . to prejudgment interest from the date of demand for its return, or in the absence of a

1. The prejudgment interest rate in a preference action is set by 28 U.S.C. § 1961, unless a trial judge finds that the equities require a different rate – a finding the court declines to make in this case. *See Banks v. Gill Distrib. Ctr., Inc.*, 263 F.3d 862, 871 (9th Cir. 2001).

prior demand, from the date of filing of the complaint." *Id.* at 305 (E.D.N.C. 1996); *In re H.P. King, Co.*, 64 B.R. 487, 489 (Bankr. E.D.N.C. 1986). The parties stipulated in the final pre-trial report, incorporated by the Final Pre-Trial Order entered by the court, that the demand letter requesting return of the transfers was sent on May 16, 2006. Accordingly, the trustee is entitled to recover prejudgment interest at the rate of 4.98% per annum, which represents the one-year constant maturity Treasury yield on the date of demand, from May 16, 2006, until the date of the amended judgment accompanying this order.[2]

II. United Rentals's Motion to Stay Pending Appeal

In considering United Rentals's motion to stay the judgment pending appeal, the court is guided by four factors: (1) the likelihood of success on the merits; (2) the likelihood of irreparable harm; (3) harm to others; and (4) whether the public interest will be served. Based on these factors, the court declines to stay the judgment pending appeal. *See e.g., Mich. Coalition of Radioactive Material Users v. Griepentrog*, 945 F.2d 150, 153 (6th Cir. 1991). First, United Rentals has failed to demonstrate that it is likely to succeed on appeal. United Rentals does not identify, either in its motion or in its supporting memorandum, any errors made by the court.

2. Because the court has ruled on the trustee's motion to alter or amend the judgment, the court denies as moot United Rentals's motion to stay the judgment pending disposition of the trustee's motion.

However, even looking to its designation of issues for appeal, the court carefully considered each issue and is not satisfied that United Rentals is likely to succeed in its appeal. Second, there is little likelihood that United Rentals will be harmed by the judgment. As its memorandum supporting its motion concedes, United Rentals is a $4 billion company, and it is not likely that it will be harmed by enforcement of the judgment prior to appeal. Third, the trustee is harmed by staying the judgment because it cannot adequately develop an orderly plan of distribution of the debtor's estate without the funds owed. Finally, having already determined that United Rentals is not likely to succeed on appeal, the public interest is better served by the expedient administration of the debtor's estate. *See e.g.*, *In re Metiom, Inc.*, 318 B.R. 263, 272 (S.D.N.Y. 2004).

## CONCLUSION

The trustee's motion to alter or amend the judgment is granted. The clerk is directed to enter an amended judgment to reflect an award of prejudgment interest in favor of the trustee from May 16, 2006, until the date of the amended judgment entered pursuant to this order, at an interest of 4.98% per annum, and thereafter at the current judgment rate. United Rentals's motion to stay pending disposition of the trustee's motion to alter or amend the judgment is denied as moot, and its motion to stay pending appeal is also denied.

"END OF DOCUMENT"

## APPENDIX D — JUDGMENT ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA, WILMINGTON DIVISION DATED MARCH 31, 2008

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF
NORTH CAROLINA
WILMINGTON DIVISION

Case No. 04-06776-8-JRL
Chapter 7

Adversary Proceeding
No. 06-00152-8-AP

IN RE:

PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Debtor.

JAMES B. ANGELL, CHAPTER 7 TRUSTEE FOR PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Plaintiff,

v.

UNITED RENTALS, INC.,

Defendant.

*Appendix D*

## ORDER

This case is before the court on the complaint of James B. Angell, chapter 7 trustee for Partitions Plus of Wilmington, Inc., against defendant United Rentals, Inc., to avoid certain preferential transfers and to recover such transfers for the benefit of the estate. On February 28, 2008, a trial was held in Raleigh, North Carolina.

## FACTS AND BACKGROUND

Partitions Plus of Wilmington, Inc. filed a chapter 11 bankruptcy petition on September 1, 2004. On November 9, 2004, the case was converted to one under chapter 7, and James B. Angell was appointed the trustee. Prior to the debtor filing bankruptcy, United Rentals supplied rental equipment to the debtor for use on certain construction projects.

On July 14, 2006, the trustee filed this adversary proceeding. The complaint alleges that Partitions Plus made preferential transfers to United Rentals in the amount of $75,849.40, and that these transfers are avoidable pursuant to 11 U.S.C. § 547(b) and recoverable under § 550(a). Both parties filed motions for summary judgment. By order dated June 4, 2007, the court concluded that the trustee established that the payments in question constituted preferential payments. The court also concluded that United Rentals was entitled to a minimum credit of $8,885.66 based on its new value defense, and that it could increase that

amount upon an appropriate showing at trial. Therefore, the sole remaining issue is the extent of United Rentals's new value defense.

## ANALYSIS

United Rentals argues that the contemporaneous exchange for new value in this case was the discharge of lien rights, bond rights, and a security interest in exchange for the preferential payments. It contends that it is irrelevant whether it would have perfected its security interests or enforced its lien and bond rights.[1] However, as the court noted in *Angell v. Pennington et al.*, Adv. Pro. 06-00148-8-AP (Bankr. E.D.N.C. March 20, 2008), the problem with presuming that the existence of inchoate rights is equivalent new value to the preferential transfer is that it effectively relieves United Rentals of its burden under 11 U.S.C. § 547(g) of establishing the actual value of the transfer. Under its theory, it would be nearly impossible for a trustee ever to maintain a preference suit against a subcontractor who possessed any sort of inchoate or hypothetical lien or bond claims.

1. United Rentals argues that it possessed lien rights and a security interest on property of the debtor. However, United Rentals presented no evidence that it ever perfected the lien. Pursuant to *Precision Walls, Inc. v Crampton*, 196 B.R. 299 (E.D.N.C. 1996), however, United Rentals was an unsecured creditor since it never perfected its lien. Therefore, it possessed no security interest or lien claim that could be extinguished in exchange for the preferential payment.

*Appendix D*

In *Pennington*, this court set forth the elements of a new value defense using an "indirect transfer" theory in a case involving a subcontractor's release of a potential bond claim. A defendant must show that (1) it would have timely filed a claim against the project's payment bond and been paid in full had it not received payment from the debtor, and (2) at the time, the debtor was still owed funds by the general contractor on which the bonding company could have asserted a lien. *Id.* at 5-6. In establishing the first element, a subcontractor must present more than a mere modicum of evidence to support its contentions. *Id.* at 7-8. For example, the defendant in *Pennington* presented sufficient evidence in the form of convincing testimony that he would have filed a bond claim, his stated policy of addressing all overdue invoices in a manner that protected his ability to file a bond or lien claim, and the fact that he filed a bond claim and was paid in full in the only other instance of nonpayment. *Id.*

In this case, however, there is no similarly corroborative evidence that United Rentals would have filed a bond claim and been paid in full had it not received the preferential payment. In fact, the only evidence that United Rentals presented at trial related to the second prong of the test, i.e., whether there were sufficient funds owing to the debtor general contractor on which the bonding company could have asserted a lien. Despite United Rentals's argument that the court can presume that the existence of potential bond and lien claims is sufficient to establish equivalent new value, *Pennington* dictates otherwise, and the failure to

produce any evidence that it would have filed a bond claim and been paid in full is fatal to United Rentals's new value defense.

## CONCLUSION

Accordingly, United Rentals has successfully established a new value defense with respect to $8,885.66 of the preferential payments. Therefore, the trustee is entitled to recover $66,963.74 of the preferential payments for the benefit of the estate. The clerk is directed to enter judgment accordingly.

"END OF DOCUMENT"

## APPENDIX E — JUDGMENT ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA, WILMINGTON DIVISION DATED JUNE 14, 2007

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF
NORTH CAROLINA
WILMINGTON DIVISION

Case No. 04-06776-8-JRL
Chapter 7

Adversary Proceeding
No. 06-00152-8-AP

IN RE:

PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Debtor.

JAMES B. ANGELL, CHAPTER 7 TRUSTEE FOR PARTITIONS PLUS OF WILMINGTON, INC., D/B/A PARTITIONS, INC., D/B/A STORM PROTECTION SYSTEMS,

Plaintiff,

v.

UNITED RENTALS, INC.,

Defendant.

*Appendix E*

## ORDER

This case is before the court on a motion for summary judgment filed by United Rentals and a motion for summary judgment filed by the trustee. On June 4, 2007, the court conducted a hearing on these matters in Raleigh, North Carolina.

## JURISDICTION AND PROCEDURE

This court has jurisdiction over the parties and the subject matter of this proceeding pursuant to 28 U.S.C. §§ 151, 157, and 1334, and the General Order of Reference entered by the United States District Court for the Eastern District of North Carolina on August 3, 1984. This is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2), which this court may hear and determine.

## FACTS AND BACKGROUND

Partitions Plus of Wilmington, Inc. filed a chapter 11 bankruptcy petition on September 1, 2004. Thereafter, on November 9, 2004, the case was converted to one under chapter 7 and James B. Angell was appointed the trustee. Prior to the debtor filing bankruptcy, United Rentals supplied rental equipment to the debtor for use on certain construction projects.

On July 14, 2006, the plaintiff filed this adversary proceeding. The complaint alleged that the debtor made payments to the defendant within the ninety days prior

the debtor's bankruptcy filing. The plaintiff contends that those payments were preferential transfers and are avoidable pursuant to 11 U.S.C. § 547(b) and recoverable under 11 U.S.C. § 550(a) in the amount of $75,849.40.

## STANDARD OF REVIEW

Under Federal Rule of Civil Procedure 56(c), made applicable in bankruptcy by Bankruptcy Rule 7056, summary judgment is proper "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." The "plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S. Ct. 2548, 2552 (1986). In making this determination, conflicts are resolved by viewing all facts and all reasonable inferences in the light most favorable to the nonmoving party. *United States v. Diebold, Inc.*, 369 U.S. 654, 655, 82 S. Ct. 993, 994 (1962).

*Appendix I*

## ANALYSIS

### A. 11 U.S.C. § 547(b)

Pursuant to 11 U.S.C. § 547(b) the trustee may recover certain preferential transfers made by the debtor in favor of specific creditors. In order for the trustee to avoid the transfers made by the debtor to the defendant, he must show that the transfers (1) were to or for the benefit of the defendant; (2) were for or on account of antecedent debts; (3) were made while the debtor was insolvent; (4) were made on or within ninety days before the debtor filed bankruptcy; and (5) enabled the defendant to receive more than he would have received if the transfers had not been made. 11 U.S.C. § 547(b). The Code places the burden on the trustee to prove the avoidability of the transfers. 11 U.S.C. § 547(g).[1] The burden of proving the nonavoidability of the transfers is placed on the creditor against whom avoidance is sought. *Id.*

It is not contested that the trustee has established the first four elements of a preferential transfer under § 547(b). The defendant received at least $75,849.40 from the debtor within ninety days of the petition date. At the time of each transfer, the debtor was insolvent, the defendant was a creditor of the debtor, and the transfers were made to or for the benefit of the defendant. The

1. As to the third element, there is a presumption that the debtor was insolvent during the ninety days prior to the petition date. 11 U.S.C. § 547(f).

only contested element relates to whether the defendant received more than he would have received if the case was under chapter 7, the transfers had not taken place, and the creditor received payment of such debt to the extent provided by the Code. 11 U.S.C. § 547(b)(5).

### *1. Express Trust*

The defendant contends that the trustee cannot meet his burden under § 547(b(5) of the Bankruptcy Code, because the monies paid to the defendant from the debtor were not property of the debtor. In support of this position, the defendant asserts that under the General Agreement of Indemnity ("Indemnity Agreement") entered into between the debtor and US Fire any monies due the debtor on any bonded contracts were to be held in trust for the benefit of the defendant.[2]

The Indemnity Agreement provided that, "[t]his Instrument shall be governed by, construed and

> 2. Where any Bond is executed in connection with a contract, the Indemnitors covenant and agree to hold all money or proceeds of such contract, whether received as payment or as loans, as a trust for the benefit of laborers, materialman, suppliers, subcontractors and the Surety to use such money or other proceeds for the purpose of performing the contract and discharging the obligation of the Bond beneficiaries, and for no other purpose . . .[.]
>
> *US Fire Aff.*, General Agreement of Indemnity.

enforced in accordance with the laws of the State of New York without regard to its principles of conflicts of laws." North Carolina recognizes that "where parties to a contract have agreed that a given jurisdiction's substantive law shall govern the interpretation of the contract, such a contractual provision will be given effect." *Tanglewood Land Co., Inc. v. Byrd*, 261 S.E.2d 655, 656 (N.C. 1980). Therefore, the court will analyze the terms of the Indemnity Agreement under New York law.

"Under New York law, an express trust must have: (1) a designated beneficiary; (2) a designated trustee who is not a beneficiary; (3) an identifiable trust res; and (4) actual delivery or assignment of the trust res with the intent of vesting legal title with the trustee." *Harleysville Worcester Mutual Ins. Co. v. Fleet Nat'l Bank (In re Suprema Specialties, Inc.)*, 2007 U.S. Dist. LEXIS 33937, at *35 (S.D.N.Y. May 7, 2007) (citing *Agudas Chasidei Chabad v. Gourary*, 833 F.2d 431 (2nd Cir. 1987)). In this case, the defendant argues that all four elements are met, and thus a trust is formed. The beneficiaries are designated as the laborers, materialmen, suppliers, subcontractors, and the surety. The debtor is designated as the trustee of the trust. The trust property is defined as "all money or proceeds" on all contracts executed in connection with any bond. Deliver of the trust property occurs when the debtor receives any money or proceeds in connection with any bonded contract. Therefore, according to the defendant the Indemnity Agreement creates an express trust which should be recognized under New York law.

*Appendix E*

The defendant's analysis inaccurately reflects the law. According to New York law, trust fund assets must be segregated, and "to commingle alleged trust funds with non-trust assets . . . by itself is fatal" to the claim of an express trust. *In re Suprema Specialties, Inc*, 2007 U.S. Dist. LEXIS 33937, at *36. By permitting commingling of funds, an indemnity agreement can prevent the identification of the trust res. *Id.* In the present case, the Indemnity Agreement did not require separate accounts for the funds received by the debtor on bonded projects. Instead the trustee's affidavit stated that the debtor maintained two bank accounts during the year prior to its filing bankruptcy. One account was used as its general operating account in which the debtor deposited all funds it received. The second account was used for payment of the debtor's payroll. The debtor's general practice was to transfer funds into the payroll account from the general operating account as needed. Furthermore, the defendant admitted that all payments it received from the debtor came from the same checking accounting, regardless of whether the payment was for a bonded or non bonded job.

Based on the facts, the court finds that there is clear evidence that the debtor intermingled the monies it received from bonded projects with those it received from non bonded projects. This commingling of alleged trust funds with non-trust funds prevented the identification of the trust res. Since all of the elements of a trust are not present, the funds from the debtor to

the defendant were not trust funds but instead were property of the debtor.[3]

*2. Equitable Lien*

Independent of the Indemnity Agreement, the defendant asserts that it had an equitable lien in the transferred funds received from the debtor on account of equipment supplied by United Rentals on any construction project. In reaching this result, the defendant relies on *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132, 83 S. Ct. 232 (1962). In *Pearlman*, the Supreme Court determined the subrogation rights of a surety that paid subcontractors on a construction project after the general contractor filed bankruptcy. *Id.* In that case, the government paid funds to the general contractor after it filed bankruptcy that had previously been retained by the government. *Id.* at 134. The trustee took possession of the funds, and the surety sued claiming that it owned the funds. *Id.* The Court held that the retained funds had never become part of the bankruptcy estate, and that "the surety, having paid the laborers and materialmen, is entitled to the benefit of all these rights to the extent necessary to reimburse it." *Id.* at 135-41.

The defendant's argument that the *Pearlman* analysis also applies to subcontractors was recently rejected by the Fourth Circuit. *See Grochal v. Ocean*

3. This flaw in itself is adequate to prevent a trust from being formed under New York law, and therefore the court will not address the merits of the other elements.

*Technical Servs. Corp. (In re Baltimore Marine Indus.)*, 476 F.3d 238, 241-42 (4th Cir. 2007) (holding that surety who has fully paid all subcontractors has a greater right to retained funds than that of an unpaid subcontractor). Therefore, the court rejects the defendant's arguments that based on *Pearlman* the transferred funds never become property of the debtor's estate, and that the defendant holds an equitable lien in the funds which entitles it to priority in payment over all subsequent lienholders and general creditors.

*3. Payment From Third Party*

Based on the analysis above, the monies paid by the debtor to the defendant were property of the debtor. The defendant additionally argues that had the debtor not paid the defendant, the defendant would have made a claim on the bonds issued in connection with the construction projects. The defendant would have received payment from the general contractor, who would have then withheld monies owed to the debtor. Based on these facts, the defendant did not receive more than it would have received if the transfers had not taken place. The flaw of this argument is that the focus of the fifth element is not on whether the defendant would have received payment from someone else for its claims.[4]

4. Although this argument does not prevent the trustee from establishing the elements of a preferential transfer, it may be used as a new value defense in limited circumstances. *See Partitions Plus of Wilmington, Inc. v. Pennington (In re Partitions Plus of Wilmington, Inc.)*, Case No. 06-00148-8-AP (Bankr. E.D.N.C. June 11, 2007).

Instead, the court must determine whether in a chapter 7 liquidation there would have been enough funds to pay this creditor's claim out of the estate if it had not been preferentially paid. *Smith v. Creative Financial Management, Inc. (In re Virginia-Carolina Financial Corp.)*, 954 F.2d 193, 199 (4th Cir. 1992). The trustee submitted an affidavit that is sufficient to establish that there are inadequate funds to provide a payout in full to unsecured creditors, and this fact is not contested by the defendant. If the defendant had not been preferentially paid, it would not have received the full amount of its claim out of the debtor's estate. Therefore, the trustee has met his burden as to the fifth element, and all the elements of § 547(b) are established.

***B. New Value Defense***

The defendant's only defense on which it seeks summary judgment is that of new value. Section 547(c)(4) provides that a preferential transfer may not be avoided, "to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor– (A) not secured by an otherwise unavoidable security interest; and (B) on account of which new value of the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor[.] 11 U.S.C. § 547(c)(4). For the purpose of § 547 "new value" is defined as,

> money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such

> transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation[.]

11 U.S.C. § 547(a)(2).

The defendant asserts that certain payments made by the debtor to the defendant were made in exchange for new value in the form of credit extended to the debtor subsequent to receipt of the transferred funds. The trustee does not dispute that the defendant is entitled to some credit against the amount of the preferential payments for subsequent advances of new value pursuant to § 547(c)(4). At the hearing, the trustee conceded that the defendant is entitled to at least a $8885.66 credit for new value.

The court finds, at this time, that the defendant is entitled to a minimum credit of $8885.66 based on new value, and it has the right to try to increase that amount upon an appropriate showing at trial. Additionally, the defendant still has available its other defenses.

## CONCLUSION

Based on the forgoing, the plaintiff's motion for summary judgment is ALLOWED. The plaintiff has met his burden of establishing that the defendant received a preferential transfer under § 547(b). The defendant's

motion for summary judgment is granted to the extent a new value credit in the minimum amount of $8885.66 is allowed, and otherwise is DENIED.

**"END OF DOCUMENT"**

## APPENDIX F — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT DENYING PETITION FOR REHEARING FILED FEBRUARY 19, 2010

FILED: February 19, 2010

**UNITED STATES COURT OF APPEALS**
**FOR THE FOURTH CIRCUIT**

No. 09-1209
(7:08-cv-00097-BO)

UNITED RENTALS, INCORPORATED,

Plaintiff - Appellant

v.

JAMES BIGELOW ANGELL,

Trustee - Appellee

**ORDER**

The Court denies the petition for rehearing and rehearing en banc. No judge requested a poll under Fed. R. App. P. 35 on the petition for rehearing en banc.

Entered at the direction of the panel: Chief Judge Traxler, Judge Shedd, and Judge Davis.

For the Court
/s/ Patricia S. Connor, Clerk